WATER PIK TECHNOLOGIES INC
Form 10-Q
May 11, 2005

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

ý **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2005

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission file number 1-15297

WATER PIK TECHNOLOGIES, INC.

(Exact name of registrant as specified in its charter)

Delaware	**25-1843384**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

23 Corporate Plaza, Suite 246
Newport Beach, CA 92660
(Address of principal executive offices, including zip code)

Registrant s telephone number, including area code: **(949) 719-3700**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2): Yes ý No o

The number of shares of Common Stock outstanding on May 9, 2005 was 12,177,226 shares.

WATER PIK TECHNOLOGIES, INC.

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PART I FINANCIAL INFORMATION

ITEM 1 FINANCIAL STATEMENTS

Water Pik Technologies, Inc.
Consolidated Balance Sheets

(In thousands, except for share and per-share amounts)

	March 31, 2005 (Unaudited)	September 30, 2004
Assets		
Current assets:		
Cash	$ 1,385	$ 11,036
Accounts receivable, less allowances of $1,834 at March 31, 2005 and $2,371 at September 30, 2004	79,464	58,418
Inventories	52,487	45,387
Deferred income taxes	8,632	8,736
Prepaid expenses and other current assets	3,231	2,803
Total current assets	145,199	126,380
Property, plant and equipment, net	42,544	45,553
Goodwill, net	35,602	35,149
Deferred income taxes	847	225
Other assets, net	4,522	3,893
Total assets	$ 228,714	$ 211,200
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 21,815	$ 26,069
Accrued income taxes		27
Accrued liabilities	22,072	32,529
Current portion of long-term debt	3,834	3,838
Total current liabilities	47,721	62,463
Long-term debt, less current portion	44,729	20,839
Other accrued liabilities	6,171	5,358
Commitments and contingencies		
Stockholders equity:		
Preferred stock, $0.01 par value: 5,000,000 shares authorized; none issued		
Common stock, $0.01 par value: 50,000,000 shares authorized; 12,143,637 and 12,282,527 shares issued and outstanding at March 31, 2005 and September 30, 2004, respectively	127	128
Additional paid-in capital	81,689	82,625
Equity adjustments due to stock plans	570	(996)
Treasury stock at cost, 704,211 and 541,343 shares at March 31, 2005 and September 30, 2004, respectively	(7,291)	(7,130)
Retained earnings	51,591	45,474
Accumulated comprehensive income	3,407	2,439

Total stockholders equity		130,093		122,540
Total liabilities and stockholders equity	$	228,714	$	211,200

See accompanying notes

Water Pik Technologies, Inc.
Consolidated Statements of Operations

(In thousands, except for share and per share amounts)
(Unaudited)

	Three Months Ended March 31, 2005	Three Months Ended March 31, 2004	Six Months Ended March 31, 2005	Six Months Ended March 31, 2004
Sales	$ 69,689	$ 67,661	$ 159,587	$ 164,772
Cost and expenses:				
Cost of sales	50,879	50,325	113,133	117,536
Selling expenses	11,435	11,176	21,975	23,510
General and administrative expenses	5,387	5,299	11,230	11,348
Research and development expenses	1,704	1,702	3,089	3,547
	69,405	68,502	149,427	155,941
Operating income (loss)	284	(841)	10,160	8,831
Interest expense	526	546	891	1,004
Other income	(96)	(70)	(304)	(128)
Income (loss) from continuing operations before income taxes	(146)	(1,317)	9,573	7,955
Income tax provision (benefit)	(58)	(468)	3,686	2,835
Income (loss) from continuing operations	(88)	(849)	5,887	5,120
Discontinued operations:				
Income (loss) from operations of discontinued product line	374		374	(45)
Income tax provision (benefit)	144		144	(15)
Income (loss) on discontinued operations	230		230	(30)
Net income (loss)	$ 142	$ (849)	$ 6,117	$ 5,090
Basic net income (loss) per common share				
Continuing operations	$ (0.01)	$ (0.07)	$ 0.49	$ 0.43
Discontinued operations	0.02		0.02	
Net income (loss)	$ 0.01	$ (0.07)	$ 0.51	$ 0.43
Diluted net income (loss) per common share				
Continuing operations	$ (0.01)	$ (0.07)	$ 0.47	$ 0.41
Discontinued operations	0.02		0.02	
Net income (loss)	$ 0.01	$ (0.07)	$ 0.48	$ 0.40
Shares used in per share calculation basic	12,050,000	11,941,000	11,997,000	11,973,000
Shares used in per share calculation diluted	12,751,000	11,941,000	12,651,000	12,581,000

Water Pik Technologies, Inc.
Consolidated Statements of Cash Flows

(In thousands)
(Unaudited)

	Six Months Ended March 31, 2005	Six Months Ended March 31, 2004
Operating activities:		
Net income	$ 6,117	$ 5,090
Loss (income) from discontinued product line	(230)	30
Income from continuing operations	5,887	5,120
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	4,825	5,157
Deferred income taxes	253	47
Tax benefit of pre-spin-off foreign tax losses		18
Compensation expense arising from stock awards	317	474
Tax benefit from restricted stock awards	73	191
Interest income from stockholder notes		(136)
Loss on sale of property, plant and equipment	8	40
Change in operating assets and liabilities, net of effects of business acquisitions:		
Accounts receivable	(20,847)	(23,378)
Inventories	(6,704)	3,471
Accounts payable	(4,364)	(198)
Accrued liabilities	(10,511)	(2,603)
Accrued income taxes	(442)	(2,281)
Other assets and liabilities	(804)	(1,679)
Cash used in operating activities	(32,309)	(15,757)
Investing activities:		
Purchase of business net of cash acquired		(10,128)
Purchase of property, plant and equipment	(1,699)	(3,118)
Disposal of property, plant and equipment	34	(7)
Cash used in investing activities	(1,665)	(13,253)
Financing activities:		
Net borrowings on revolving credit facilities	25,789	27,168
Payments on promissory notes	(1,891)	(1,897)
Proceeds from exercise of stock options	171	1,086
Acquisition of treasury stock	(161)	
Principal payment on capital leases	(10)	(10)
Cash provided by financing activities	23,898	26,347
Effect of exchange rate changes on cash	195	(103)
Cash provided by (used in) discontinued operations	230	(30)
Decrease in cash	(9,651)	(2,796)
Cash at beginning of period	11,036	3,888
Cash at end of period	$ 1,385	$ 1,092

See accompanying notes

Water Pik Technologies, Inc.

Notes to Consolidated Financial Statements

(Unaudited)

1. Basis of Presentation

DESCRIPTION OF BUSINESS

In accordance with the Securities and Exchange Commission s Plain English guidelines, this Quarterly Report on Form 10-Q has been written in the first person. In this document, the words we , our , and us refer to Water Pik Technologies, Inc. and not any other person.

We are a leader in designing, manufacturing and marketing a broad range of well-recognized personal healthcare products and pool products and water-heating systems. Our products include: showerheads; consumer and professional oral health products; water filtration products; swimming pool and spa heaters, heat pumps, heat exchangers, electronic controls, valves, pumps, filters, automatic salt chlorine generators, titanium heat exchangers, water features and accessories; and residential and commercial water-heating systems. We operate in two business segments: the Personal Health Care segment and the Pool Products and Heating Systems segment.

FISCAL YEAR

In January 2004, we changed our fiscal year end from the Sunday nearest December 31 to the Sunday nearest September 30. As a result of this change, we reported a nine-month transition period ended September 30, 2004. We operate on a 52- or 53-week fiscal year with fiscal quarters ending on the Sunday nearest to the end of the applicable thirteen-week period. The fiscal quarter and year-to-date periods presented in our consolidated financial statements are presented as of the last day of the calendar quarter for convenience. This Form 10-Q is for the three month period ended April 3, 2005, but for presentation purposes, is described as the three month period ended March 31, 2005.

SEASONALITY

Our business is highly seasonal, with operating results varying from quarter to quarter. The Personal Health Care segment has generally experienced higher sales in the quarter ending in December of each fiscal year due to stronger retail demand during the holiday season. The Pool Products and Heating Systems segment has historically experienced higher sales in the quarters ending in June and December of each fiscal year as customers purchase such products in preparation for the cooler weather and in anticipation of the warm spring and summer months. In addition, as a result of the seasonality of sales, the Pool Products and Heating Systems segment offers incentive programs and extended payment terms to encourage pool product customers to purchase products from September through December, as is consistent with industry practice. The extended payment term receivables are collected during the spring and summer months, which creates a seasonal peak in working capital and borrowing levels during the winter months. Variations in operating results can also occur due to short-term trends such as changes in the economic environment, consumer spending, product sourcing arrangements and weather patterns.

UNAUDITED INTERIM FINANCIAL INFORMATION

Our consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In management s opinion, all adjustments, consisting primarily of normal recurring accruals, considered necessary for a fair presentation have been included. Certain prior year amounts have been reclassified to conform to the current year financial statement presentation. These reclassifications had no effect on reported results of operations or stockholders equity. The information included in this Form 10-Q should be read in conjunction with our Transition Report on Form 10-KT, as amended, for the transition period from January 1, 2004 through September 30, 2004, including information regarding our critical accounting policies and estimates. Operating results for the interim periods presented are not necessarily indicative of the results to be expected for the twelve months ending September 30, 2005.

RECENT ACCOUNTING PRONOUNCEMENTS

In December 2004, the Financial Accounting Standards Board (FASB) finalized Statement of Financial Accounting Standards (SFAS) No. 123R, Share-Based Payment, which requires companies to measure compensation costs for all share-based payments (including employee stock options) at fair value, effective for interim or annual periods beginning after June 15, 2005. SFAS No. 123R provides two tentative adoption methods. The first method is a modified prospective transition method whereby a company would recognize share-based employee costs from the beginning of the fiscal period in which the recognition provisions are first applied as if the fair-value-based accounting method had been used to account for all employee awards granted, modified, or settled after the effective date and to any awards that were not fully vested as of the effective date. Measurement and attribution of compensation cost for awards that are non-vested as of the effective date of SFAS No. 123R would be based on the same estimate of the grant-date fair value and the same attribution method used previously under SFAS No. 123. The second adoption method is a modified retrospective transition method whereby a company would recognize employee compensation cost for periods presented prior to the adoption of SFAS No. 123R in accordance with the original provisions of SFAS No. 123, Accounting for Stock-Based Compensation that is, an entity would recognize employee compensation costs in the amounts reported in the pro forma disclosures provided in accordance with SFAS No.

123. A company would not be permitted to make any changes to those amounts upon adoption of SFAS No. 123R unless those changes represent a correction of an error. For periods after the date of adoption of SFAS No. 123R, the modified prospective transition method described above would be applied.

On April 15, 2005, the U.S. Securities and Exchange Commision (the SEC) announced a deferral of the effective date of SFAS No. 123R until the first interim or annual reporting period of the first fiscal year beginning on or after June 15, 2005.

We expect to adopt SFAS No. 123R for the quarter ending December 31, 2005. We are reviewing our alternatives for adoption under this new pronouncement. The impact of adoption of SFAS No. 123R cannot be predicted at this time because it will depend on levels of share-based payments granted in the future. However, had we adopted SFAS No. 123R in prior periods, the impact of that standard would have an effect on our results of operations similar to the amounts reported historically in our footnotes under the pro forma disclosure provisions of SFAS No. 123.

In December 2004, the FASB issued FASB Staff Position No. 109-1, Application of FASB Statement No. 109 (SFAS 109), Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004 (FSP 109-1). FSP 109-1 clarifies that the manufacturer s deduction provided for under the American Jobs Creation Act of 2004 (the Act) should be accounted for as a special deduction in accordance with SFAS 109 and not as a tax rate reduction. The adoption of FSP 109-1 will have no impact on our results of operations or financial position for fiscal year 2005, as the manufacturer s deduction is not available to us until fiscal year 2006. We are currently evaluating the effect that the manufacturer s deduction will have in subsequent years.

In December 2004, the FASB also issued FASB Staff Position No. 109-2, Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004 (FSP 109-2). The Act introduces a special one-time dividends received deduction on the repatriation of certain foreign earnings to a U.S. taxpayer (repatriation provision), provided certain criteria are met. FSP 109-2, which was effective for the quarter ended December 2004, provides accounting and disclosure guidance for the repatriation provision. We are currently evaluating our alternatives under the provision of the Act, which had no impact on our consolidated results of operations or financial position for the periods presented.

In November 2004, the FASB issued SFAS No. 151, Inventory Costs, an amendment of ARB No. 43, Chapter 4. SFAS 151 clarifies that abnormal inventory costs such as costs of idle facilities, excess freight and handling costs, and wasted materials (spoilage) are required to be recognized as current period charges. The provisions of SFAS 151 are effective for the fiscal year beginning after June 15, 2005. We are currently evaluating the impact that this statement will have on our financial statements.

2. Inventories

We value our inventory at the lower of its cost to purchase or manufacture (last-in, first-out (LIFO) and first-in, first-out (FIFO) cost methods) or its current estimated market value. Inventories consist of the following:

	March 31, 2005	September 30, 2004

	(In thousands)			
Raw materials and supplies	$	19,543	$	16,906
Work-in-process		3,587		3,154
Finished goods		34,239		30,093
Total inventories at current cost		57,369		50,153
Less: Allowances to reduce current cost values to LIFO basis		(4,882)		(4,766)
Total inventories	$	52,487	$	45,387

Inventories determined using the LIFO cost method were $43,666,000 at March 31, 2005 and $37,091,000 at September 30, 2004, net of LIFO reserves. The remainder of our inventories were determined using the FIFO cost method.

3. Acquisition

On January 20, 2004, as part of our strategic objective to accelerate sales and profit growth in our pool business through development of a more comprehensive package of pool equipment and accessories, we acquired from Finchem USA, Inc. (Finnchem) substantially all of the assets of Huron Tech Systems, a Jacksonville, Florida manufacturer of automatic salt chlorine generators, used for swimming pool and spa water sanitation, and titanium heat exchangers, a component used in premium heat pumps. The purchase price after adjustments totaled $10,128,000 (consisting of $10,000,000 in cash and $128,000 in direct acquisition costs). As of March 31, 2005, the final allocation of the purchase price resulted in $9,127,000 of goodwill, $100,000 of identifiable intangible assets with estimated three- to five-year lives, $1,494,000 of current assets (primarily accounts receivable and inventory), $120,000 in property, plant and equipment and $713,000 in assumed liabilities. During the three months ended December 31, 2004, the allocation of the purchase price was adjusted to reflect additional information regarding the value of liabilities assumed and estimated contingent payments, which resulted in additional goodwill of $243,000. The goodwill was assigned to the Pool Product and Heating Systems segment and is expected to be deductible for tax purposes. In connection with the acquisition, we entered into a component supply agreement for a period of five years with Finnchem. The results of operations of Huron Tech Systems are included in our consolidated results of operations beginning January 20, 2004.

4. Long-Term Debt

Long-term debt is comprised of the following:

	March 31, 2005	September 30, 2004
	(In thousands)	
Revolving credit facility	$ 25,847	$ 60
Mortgage notes payable	17,707	18,119
Promissory notes payable equipment financing agreement	4,964	6,443
Other	45	55
	48,563	24,677
Less: Current portion	(3,834)	(3,838)
Long-term debt	$ 44,729	$ 20,839

We utilize interest rate swap agreements as cash flow hedges to lock in the interest rate on borrowings and achieve a desired proportion of variable versus fixed-rate debt. At March 31, 2005 and September 30, 2004, we had outstanding two interest rate swap agreements related to borrowings under the equipment financing agreement with an aggregate notional amount of $3,601,500 and $4,630,000, respectively; these interest rate swap agreements expire on January 1, 2007. On a pre-tax basis, the changes in their fair values resulted in a gain of $64,000 and a loss of $25,000 for the three months and six months ended March 31, 2005, respectively, and gains of $14,000 and $75,000 for the three months and six months ended March 31, 2004, respectively, which have been recognized in accumulated comprehensive income within stockholders equity. The counterparty to these interest rate swap agreements is a major financial institution. We continually monitor the credit quality of the financial institution and anticipate full performance by the counterparty.

Our revolving credit facility and our real estate loan agreement and related mortgage notes require us to be in compliance with specific financial and non-financial covenants and restrictions relating to indebtedness, liens, investments, dividends, fixed charge coverage, capital expenditures and the relationship of our total consolidated indebtedness to EBITDA (earnings before interest, income taxes, depreciation and amortization). We were in compliance with these covenants at March 31, 2005.

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5. Stock Based Compensation

We account for stock-based employee compensation arrangements in accordance with the provisions of Accounting Principles Board (APB) No. 25, Accounting for Stock Issued to Employees, and comply with disclosure provisions of SFAS No. 123. If we had elected to recognize compensation cost for stock options based on their fair value at the grant dates, consistent with the method prescribed by SFAS No. 123, net income and net income per share, for the three months and six months ended March 31, 2005 and 2004 would have been as follows:

	Three Months Ended March 31, 2005	Three Months Ended March 31, 2004	Six Months Ended March 31, 2005	Six Months Ended March 31, 2004
	(In thousands, except per share amounts)		(In thousands, except per share amounts)	
Net income (loss), as reported	$ 142	$ (849)	$ 6,117	$ 5,090
Stock-based compensation expense included in reported net income (loss), net of tax	74	107	184	311
Total stock-based compensation expense determined under the fair value based method for all awards, net of tax	(351)	(237)	(760)	(622)
Pro forma net income (loss)	$ (135)	$ (979)	$ 5,541	$ 4,779
Basic net income (loss) per common share:				
As reported	$ 0.01	$ (0.07)	$ 0.51	$ 0.43
Pro forma	$ (0.01)	$ (0.08)	$ 0.46	$ 0.40
Diluted net income (loss) per common share:				
As reported	$ 0.01	$ (0.07)	$ 0.48	$ 0.41
Pro forma	$ (0.01)	$ (0.08)	$ 0.44	$ 0.38

For purposes of pro forma disclosure, the estimated fair value of the options is amortized ratably over the options vesting period. Under SFAS No. 123, the fair value of each option grant was estimated on the date of grant using the Black-Scholes option valuation model. The following weighted average assumptions were used in estimating the fair value of option grants: an expected dividend yield of zero percent, an average expected life of the options of six years, an expected volatility of 40.2 percent and a risk-free interest rate of 3.7 percent. There were 5,000 options granted in the six months ended March 31, 2005. The weighted average fair value of options granted in the six months ended March 31, 2005 was $6.77. There were no options granted during the three months and six months ended March 31, 2004.

6. Employee Stock Compensation Plans

On March 9, 2004, our Board of Directors approved, and on May 13, 2004, our stockholders approved, an amendment to the Water Pik Technologies, Inc. 1999 Incentive Plan (Incentive Plan), to limit the number of shares of common stock authorized to be issued, eliminate adjustments to authorized shares under the Incentive Plan as a percentage of our outstanding shares, prohibit the repricing of outstanding stock options and other awards and re-approve the terms of cash awards and performance goals. The amendment also created a deferred compensation feature to allow designated Incentive Plan participants to defer the receipt of stock option gains, shares of restricted stock and any stock appreciation rights or other compensation awards payable in shares of common stock. Pursuant to the amendment, on November 26, 2004, certain executive officers deferred receipt of 153,690 shares of restricted stock. Under the terms of the Incentive Plan, the deferral resulted in cancellation of 153,690 shares of restricted stock and the addition of 153,690 shares to the Incentive Plan, which shares have been reserved for reissuance to the officers in accordance with their individual distribution elections. There are currently 2,053,690 authorized shares under the Incentive Plan, including the shares added as a result of the deferral. The deferred shares were included in treasury stock and equity adjustments due to stock plan components of equity as of March 31, 2005. The deferral had no impact on total stockholders equity as of March 31, 2005.

As of March 31, 2005, there were 425,433 shares available for issuance under the Incentive Plan, of which 153,690 were committed to the restricted stock deferral participants and 195,453 were committed in the event of maximum achievement of performance goals under the 2004 through 2006 Performance Share Plan (PSP). As of March 31, 2005, there were 36,058 shares available for issuance under the 1999 Broad-Based Stock Option Plan and 84,558 shares available for issuance under the Stock Acquisition and Retention Program, of which none were committed. On May 4, 2005, our Board of Directors approved a grant of 30,000 restricted common shares to certain key employees pursuant to our Incentive Plan. (See Note 14, Subsequent Events). Following the May 4, 2005 grant, there are 395,433 shares available for issuance under the Incentive Plan. In addition, subsequent to March 31, 2005, the number of shares committed to participants under the PSP in the event of maximum achievement of performance goals was adjusted to 180,881 due to refinements for personnel changes.

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